In the

United States Circuit Court of Appeals

For the Ninth Circuit

No. 7820

NORTH RIVER INSURANCE COMPANY, a corporation, Appellant and Cross-Appellee,

vs.

GUY H. CLARK, as Receiver of the MONTBORNE LUMBER COMPANY, a corporation, Appellee and Cross-Appellant.

BRIEF OF CROSS-APPELLEE

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INDEX

TABLE OF CASES

TEXTS

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As has been done in the brief of appellant and in the brief of cross-appellant, in this brief we shall continue to refer to the parties as plaintiff and defendant, the positions they occupied in the lower court.

STATEMENT OF FACTS

All of the facts involved in this cross appeal are contained in stipulations which are complete and concise. Tr. 33-57). For the convenience of the court, however, we wish to summarize the salient features of this controversy.

This action was instituted by the receiver of the Montborne Lumber Company on May 2, 1931, against the defendant to recover losses under a policy of insurance.

The policy in question (Tr. 49-57) specifically insured a certain Shay logging locomotive belonging to plaintiff and also covered

" . . . the legal liability only of the assured on logging cars owned by others in the possession of assured . . . "

against certain hazards including derailment, fire, collision, collapse of bridges, lightning, cyclone, tornado and flood.

A forest fire occurred on September 4, 1930, destroying certain bridges and trestles on the logging railroad, so that the Shay locomotive was marooned in the woods. The locomotive itself was never in contact with the fire and sustained no physical damage. The trial court allowed recovery for the stipulated value of the locomotive. This recovery is the basis of de-

fendant's appeal, upon which question a brief has heretofore been served and filed. The cross appeal concerns itself only with the denial of recovery on account of damage to certain Northern Pacific logging flat cars.

The complaint sets out three causes of action as follows:

First Cause of Action

In the first cause of action, in addition to the Shay locomotive, the receiver seeks to recover for the loss occasioned by the destruction of 12 Northern Pacific logging flat cars by the forest fire which occurred September 4, 1930.

Second Cause of Action

The second cause of action involves 5 additional Northern Pacific logging flat cars. Recovery is sought under the insurance policy for derailment alleged to have occurred August 30, 1930.

Third Cause of Action

The third cause of action seeks recovery for 5 additional Northern Pacific logging flat cars. It is alleged that these cars were derailed on August 30, 1930, and while so derailed were, on September 4, 1930, destroyed by fire. Recovery is sought for this loss.

The following facts bearing upon the questions of law presented in the cross appeal are shown by the stipulations:—

(a) 22 Northern Pacific logging flat cars were in the possession of plaintiff under an interchange agreement dated December 19, 1927, and attached as Exhibit 1 to the stipulation (Tr. 39). This agreement provided for the use by plaintiff of Northern Pacific logging flat cars. In this connection it is therein provided:

"The Lumber Company agrees to pay the railroad for all damage which cars delivered to it by the railroad . . . may sustain from any cause whatever while in its possession . . . "

(b) On August 30, 1930, 5 N. P. flat cars were derailed and damaged in the amount of $482.13, which damage was fully repaired *by the Railway Company at its expense.*

(c) On September 4, 1930, these 5 cars and 17 additional N. P. cars were in possession of the plaintiff and were destroyed by a forest fire.

(d) " . . . the loss and damage caused by derailment and/or fire to all of said cars was in the total sum of $8,000."

(e) The plaintiff became insolvent and went into receivership some time after the fire.

(f) On November 28, 1931, an amended claim in the receivership was filed by the Northern Pacific. This amended claim is attached to the stipulation as Exhibit 3 (Tr. 35). As to the flat cars which form the basis of the first, second and third causes of action, the Northern Pacific in the amended claim states:

"That it neither had nor makes any claim against said Montborne Lumber Company or said receiver, for or on account of any legal liability or otherwise for damage to or failure to return" said cars " . . . and releases and discharges said Montborne Lumber Company and its receiver from any and all legal liability for or on account of damage to said cars or failure to return the same pursuant to the interchange contract above referred to or otherwise."

(g) On February 26, 1931, the defendant Insurance Company paid to the Northern Pacific the sum of $8,000 in full settlement and satisfaction of any and all claims the Northern Pacific might have against the defendant Insurance Company or the plaintiff Lumber Company on account of the damage to or destruction or loss of any and all cars of the Northern Pacific covered by the said policy of insurance.

SUMMARY OF ARGUMENT

The defendant's position on this cross appeal is this: The policy in question so far as the Northern Pacific logging flat cars are concerned is either an indemnity or a liability policy. In either event, plaintiff is not entitled to recover because:

(A) If it is an indemnity policy the plaintiff cannot recover, because:

(1) The claim has been extinguished; or,

(2) The plaintiff has no claim against the defendent until it has sustained *and* paid the loss.

(B) If it is a liability policy, plaintiff cannot recover, because:

(1) The claim is extinguished;

(2) The Northern Pacific could sue the plaintiff direct and enforce collection against defendant. The court will not compel an idle act.

There are two additional defenses to plaintiff's action:

(1) Plaintiff cannot show an existing liability to the Northern Pacific.

(2) A constructive trust in favor of the owner of property is impressed upon the proceeds of an insurance policy taken out by a party in possession, even if taken without the knowledge of the owner.

The Issue

Reduced to its lowest terms the question of law for determination is whether or not the defendant is liable to the plaintiff for the destruction of Northern

Pacific flat cars under an insurance policy insuring the plaintiff against the legal liability only of the plaintiff to the Northern Pacific, when the Northern Pacific has received full satisfaction for said destroyed cars and has released the plaintiff from any legal liability.

Stated in another way, may the plaintiff collect from the defendant as and for legal liability to the Northern Pacific when the Northern Pacific makes no claim and releases and discharges the plaintiff from all liability?

ARGUMENT

Plaintiff's Contention

As stated on page 6 of plaintiff's brief as cross-appellant, it is plaintiff's position that

"The policy sued upon was a policy of fire insurance and under the law of the State of Washington, the only way an insurer may relieve itself of liability on a fire insurance policy is by payment to the named assured."

The difficulty with plaintiff's argument is that, in substance, it ignores or rejects the plain language of the policy in question and assumes the fundamental fact necessary to otherwise sustain its position.

Policy is Not a Fire Insurance Policy

So far as the Northern Pacific flat cars are concerned, the policy is not, strictly speaking, a fire insurance policy on certain specific property. By the very language of the endorsement of the policy "*the legal liability only*" as to the flat cars is covered by the policy.

The endorsement on the policy reads (Tr. 56):

"It is also understood and agreed that this policy covers the *legal liability only* of the assured on logging cars owned by others in the possession of the assured . . . " (Italics ours).

A brief reference to the situation of the parties and the facts will show that the policy, so far as the logging flat cars are concerned, was never intended to be other than what the language of the endorsement recites.

It will be noted by a reading of the policy that two classes of property are involved, (1) a Shay locomotive owned by plaintiff; (2) logging flat cars owned by others.

The stipulation shows (Tr. 35):

"(7) That on August 11, 1930, and for a long time prior thereto, and until the time of the fire before mentioned, the Railway Company furnished the Lumber Company its flat cars, main line tanks and coal gondolas for the purpose of loading and/or unloading

freight under said interchange agreement; that the Lumber Company did not own any logging flat cars, main line tanks or coal gondolas, and that all rolling equipment of said character used or intended to be used at any time material to this litigation upon the logging railroad of the Lumber Company was rolling equipment owned by the Railway Company and furnished pursuant to the said interchange agreement."

and further shows (Tr. 37):

"(2) That no flat cars, main line tanks or coal gondolas other than those herein described belonging to others than the Lumber Company were upon the logging railroad or in the possession of the Lumber Company at the time of the fire."

It will be noted, therefore, that the only rolling equipment other than the plaintiff's own property (the Shay locomotive), which was intended by the parties to be covered by the insurance policy was rolling equipment of the Northern Pacific. No "main line tanks or coal gondolas" were damaged,—hence this controversy concerns only N. P. logging flat cars in the possession of plaintiff pursuant to the interchange agreement.

Under the interchange agreement of December 19, 1927 between the Northern Pacific and plaintiff (Tr. 39-41):

"The Lumber Company agrees to pay the Railroad for all damage which cars delivered to it by the Railroad . . . sustain from any cause whatever while in its possession . . . "

It is apparent, therefore, that in view of this interchange agreemnt, the insurance which plaintiff obtained through defendant was for the obvious purpose of protecting it from possible liability in the event of damage to the cars of the Northern Pacific.

The fact that the policy is not limited to damage by fire, is the best evidence that it is not a fire insurance policy. The policy also insured against the hazards of derailment, collision, collapse of bridges, lightning, cyclone, tornado and flood. By the express terms of the endorsement attached to the policy it was not direct insurance of property, so far as these cars were concerned, but only insurance against *legal liability* proximately caused by the namd hazards.

Thus, if damage had occurred to one of the Northern Pacific logging flat cars by flood, (a hazard insured against) but for which the plaintiff was not legally liable to the Northern Pacific, plaintiff could not recover from defendant therefor.

That this is not a fire insurance policy is further evidenced by the stipulation (Tr. 36) showing that five of the flat cars were derailed prior to the fire and were repaired by the Railway Company at its own expense. The Railway Company of course had a valid claim for this item under the interchange agreement.

trial court in its memorandum decision reported in 8 F. Supp. 394 (Tr. 62 and appendix to this brief):

"In the law relating to insurance as well as other contracts, the rule is that specific provisions must control over general provisions, and construing the policy, together with said endorsement, it is obvious that the parties intended that liability of the assured rather than loss or damage to the insured, was the thing insured against."

As previously stated, plaintiff construed the effect of this policy of insurance just as if the endorsement were not a part of it. But even such a view will not avail plaintiff for, if the endorsement be emasculated or ignored, then, under the stipulation of facts, there can be no recovery to plaintiff because the plaintiff has no interest or partial ownership in the property. The sole basis of any recovery whatever, therefore, is necessarily predicated on plaintiff's liability over to the Northern Pacific. If this be not so, then this becomes a pure wagering contract, and of course is void.

"If the person procuring or holding the contract of insurance has no such interest, the contract is invalid, the objection to such contract being that there is a mere wager on an event in the happening of which insured has no interest."

26 C. J. 18.

Fire Insurance Policy is an Indemnity Policy

It was the position of plaintiff below, and the plaintiff apparently in its brief adheres to the view, that a

fire insurance policy is neither an indemnity nor liability policy. Plaintiff conceded in the court below, and we gather from its brief on appeal, that if the policy in question is in fact not a fire insurance policy, but either an indemnity or liability policy, the insurer may extinguish the liability or discharge the claim indemnified against without the consent of the assured.

The policy in question is either an indemnity policy or liability policy and, as will be developed hereinafter, whichever view is taken of the policy the result is the same. Plaintiff cannot recover.

All insurance, except life, can be generally classified as either indemnity or liability, depending upon whether the insurance is against loss, or against liability for loss.

Generally speaking, a fire insurance policy, (except as provided by specific endorsement), when it is an insurance for loss by fire to property, is an indemnity policy because it is an insurance against loss.

"The contract of (fire) insurance, as all know is a contract of indemnity upon the terms and conditions specified in the policy of insurance."

Glendale Woolen Co. v. Protection Ins. Co., 21 Conn. 19, 31.

"The general, if not universal, rule is that fire insurance contracts are purely indemnity contracts * * *"

Millard v. Beaumont, 185 S. W. 547, (Mo.).

A fire insurance policy is—

"A contract of indemnity * * * to reimburse the insured for an actual loss (by fire) not exceeding an agreed sum."

Getchell v. Mercantile, etc., F. Ins. Co., 83 Atl. 801 (Me.).

"A fire policy is a contract to indemnify in case of loss."

Commonwealth v. American Life Ins. Co., 29 Atl. 660 (Pa.).

"Fire insurance is a contract of insurance by which the insurer for a consideration agrees to indemnify the insured against loss of or damage to property by fire. * * * The contract is of indemnity only. * * *"

26 C. J. 17.

We, therefore, respectfully submit that *under all authority*, strictly speaking, a fire insurance policy is an indemnity policy, except where the policy is removed from this classification because of specific endorsement.

Distinction Between Indemnity and Liability Policy

The distinction between the two classes of insurance policies has been thus stated by the Supreme Court of the State of Washington:

"The test as to whether this is a liability or indemnity bond seems to be: If the intention of the parties thereto was to protect the assured from liability for damages, or to protect persons damaged by injuries occasioned by the assured, as specified in the contract, when such liability should accrue and be imposed by law (as by a judgment of a competent court), it is a liability bond; if, on the other hand, it is only to indemnify the assured against actual loss by them—that is, for reimbursement to them for moneys they had been obliged to pay and had paid, it would be an indemnity bond only, protecting only the assured."

Fenton v. Poston, 114 Wash. 217, 224; 195 Pac. 31.

To the same effect see *Ford v. Aetna Life Ins. Co.*, 70 Wash. 29, 126 Pac. 69, and cases therein cited. Judge Gose, in commenting upon one of the cited cases, says:

"The policy was identical in meaning with the policy in controversy. The court said, that the policy insured against loss only; that no obligation arose until the assured had paid the loss;"

Ford v. Aetna Life Ins. Co., 70 Wash. 29, 35, 126 Pac. 69.

Assuming Indemnity Policy

If, then, the policy we are considering is construed to be an indemnity policy, the assured cannot maintain its cause of action until it has actually suffered and paid the loss. The basis of recovery under an indemnity policy is not threat of loss, but actual loss.

Ordinarily, as above pointed out, a fire insurance policy is construed to be an indemnity policy, and the rights under an indemnity policy are usually personal to the assured, but this generalization is of no avail to plaintiffs because this is not a fire insurance policy in the ordinary sense of the expression. It is an insurance against *legal liability only*. Construed, however, as an indemnity policy, under the facts disclosed in the stipulation there has been no actual loss and there can be no actual loss and there will be no actual loss to the plaintiff until the plaintiff first pays to the Northern Pacific the value of the destroyed flat cars.

We also particularly draw the attention of the court to the rule that even in an indemnity policy where the assured must first sustain and pay the loss before any right under the policy accures, the Insurance Company may of its own volition deal with and extinguish the claim of the injured or damaged party against the assured.

Thus in *Sanders v. Frankfort Marine, etc., Ins. Co.*, 57 Atl. 655 (N. H.), in which case the policy was assumed to be an indemnity policy, the Supreme Court of New Hampshire said:

"But whether such power exists or not, the indemnitor has the right to perform his contract of indemnity by payment of the claim indemnified against." (p. 656.)

There is no question as to this rule. We have found *no* cases to the contrary, and plaintiff has not contended otherwise. At all events it is logical that the rule should be as stated. When a person is damaged and makes claim against an insurer because thereof, there can be no substantial reason for denying the right of the insurance company under an indemnity policy to extinguish this claim by settling direct with party damaged. While it is true, under the weight of authority, that the injured party would not have a cause of action direct against an insurance company on an indemnity policy, still if the insurance company elects voluntarily to extinguish the claim, there can be no cause of complaint.

The assured cannot complain because—

(1) The claim has been extinguished.

(2) The assured would have no claim against the Insurance Company until first it had sustained and paid the loss.

In considering the cases involving policies of insurance, courts frequently have been careless in distinguishing between indemnity and liability policies. In those cases, however, wherein the specific question is tendered as to the distinction between the two classes of policies, there is no confusion. We draw this particularly to the attention of this court because in some

cases wherein the distinction has not been presented and was not necessarily to a decision, language is used which is obviously without reference to the particular character of the policy in question.

So much for a consideration of the policy in question construed as an indemnity policy. Clearly plaintiff is not aided by such a view.

"No obligation arose until the assured had paid the loss."

(*Ford v. Aetna Life Ins. Co., supra.*)

Moreover, the claim has been extinguished because—

"* * * the indemnitor has the right to perform his contract of indemnity by payment of the claim indemnified against."

(*Sanders v. Frankfort Marine, etc., Ins. Co., supra.*) This the indemnitor has done in the instant case. It has paid the claim indemnified against by paying the Northern Pacific Railway Company.

In this connection, assuming the policy in question to be a fire insurance policy, we wish to call attention to the case particularly relied on by plaintiff, *Nelson v. Nelson Neal Lumber Co.*, 171 Wash. 55, 17 Pac. (2d) 626. In addition to this case many others might be cited to the proposition that payment by the insurance company to the named assured would discharge

the liability of the insurance company. That is all that the *Nelson* case holds. It is but common sense to hold that payment by the insurance company to the named assured, without knowledge or notice of the rights of third parties, has the effect of discharging the liability of the insurance company. But the *Nelson* case and similar cases which might be cited are not authority on the question as to whether or not extinguishment of the liability or claim indemnified against does not also discharge the insurer. There is no inconsistency between the two propositions.

Assuming Liability Policy

On the other hand, assuming that the policy is of the character which is generally described as a liability policy, plaintiff is not aided.

In the first place, in a liability policy, as in an indemnity policy, the insurance company may settle direct with the party injured or damaged. Thus, in *Anoka Lumber Co. v. Fidelity & Casualty Co.*, 65 N. W. 353, (Minn.), which involved a liability policy, the court held that the insurance company had the right to assume and settle or pay the claim of the injured party.

We have found *no* cases to the contrary and plaintiff has not contended otherwise. In logic this must

be so. The assured is not damaged because the claim is extinguished; the party injured cannot complain because his claim is satisfied. There is a full performance by the insurance company by the assumption and payment of the liability.

Secondly, under the decisions, if the Northern Pacific sued and obtained judgment against the plaintiff for the destruction of the cars, (which, of course, it would have a right to do), it could immediately proceed against the Insurance Company direct and enforce collection without the proceeds of the policy passing through the hands of the assured. That this is so has been held in the case of *Fenton v. Poston*, 114 Wash. 217, 195 Pac. 31, involving a liability policy, and where a garnishment after judgment was successfully invoked.

This court will not compel an idle act as a condition precedent to the legal approval of that which has already been accomplished, and which would be accomplished by the performance of the ritualistic act.

Apart from the foregoing considerations, there are two further insurmountable defenses to plaintiff's action:

No Existing Liability

(1) Assuming a destruction of the flat cars by fire, unless the plaintiff is legally liable by reason thereof

to the Northern Pacific, it could not successfully maintain its action against the Insurance Company. Stated in another way, it is essential to plaintiff's cause of action that it plead and prove an existing legal liability to the Northern Pacific. Here the Northern Pacific has released its claim against the plaintiff. It would be an anomalous situation to permit a recovery as and for a liability which has been extinguished and is non-existent.

Rule of Constructive Trusts

(2) A constructive trust in favor of the owner of property is impressed upon the proceeds of an insurance policy taken out by a party in possession, even if taken out without the knowledge of the owner.

There is no question but that the delivery of possession of personalty for the purpose of transportation and for use and return is a bailment.

6 C. J. 1099

"A bailment may be defined as a delivery personalty for some particular purpose * * upon a contract, express or implied, but after the use has been fulfilled, it shall be redelivered to the person who delivered it * * *"

6 C. J. 1084.

Here, the plaintiff was a bailee in possession of flat cars owned by the Northern Pacific. An insurance policy was taken out by the bailee. Even if it be as-

sumed that the insurance policy was taken out without the knowledge of the owner, in the event of the destruction of the property the proceeds of the policy are impressed with a trust in favor of the owner.

"And one having an interest in the property, may claim the advantage of the policy, although it was taken without his direction or knowledge, a ratification or adoption of the act of the holder of the property insuring it for the benefit of others being sufficient;"

26 C. J. 444.

To the same effect, in addition to cases hereinafter cited, see:

Waters v. Monarch Life & Fire Ins. Co., 25 L. J. Q. B. 102 (1856);

Waring v. Indemnity Fire Ins. Co., 45 N. Y. 606;

Stillwell v. Staples, 19 N. Y. 401.

It is axiomatic that one may not maintain an action on a policy of insurance which he has obtained unless he has an insurable interest therein.

"If the person procuring or holding the contract of insurance has no such interest, the contract is invalid, the objection to such contract being that there is a mere wager on an event in the happening of which insured has no interest."

26 C. J. 18.

Here the plaintiff as bailee of these flat cars, had as its only insurable interest its contractual liability to the Northern Pacific in the event of damage, loss or

destruction of the cars. Stated in another way, the only conceivable loss which the plaintiff could sustain as to the flat cars, would be its liability to the Northern Pacific Railway Company. Its liability to the Northern Pacific was all inclusive, because the plaintiff agreed to pay the railroad for all damage to the cars "from any cause whatsoever while in its possession". To make this a valid contract of insurance, therefore, requires that it be construed so as to give the plaintiff an insurable interest. This does not mean, however that the property cannot be insured for its full value by the plaintiff:

"Any bailee or person in custody of property and responsible for it may take insurance in his own name, and may recover not only a sum equal to his own interest in the property, * * * but the full amount in the policy up to the value of the property."

26 C. J. 25.

When, therefore, insurance is taken out by a bailee or one holding property in trust, even without the knowledge of the owner, the interest of the true owner is protected and the proceeds of the policy in the event of loss is a trust fund for the benefit of the owner:

"The insurance is not, however, merely on the interest of the one who takes out the policy, but covers the entire value of the property; and insured may recover such value, accounting to the real owner, who sees fit to avail himself of the benefit of the insurance, for any excess beyond the interest or liability of insured, although the insurance may be so taken as to

cover only the liability of the insured and preclude any recovery by him for the benefit of the owner. The owner of the goods may adopt the benefit of the policy even after a loss. As a rule, no act or omission of the person procuring the insurance can defeat the recovery by the owner of the goods of his share of the proceeds."

26 C. J. 86.

Home Insurance Co. v. Baltimore Warehouse Co.

The leading case in this country in support of the principles above stated and in support of the rule that if the plaintiff successfully maintained its action here against the Insurance Company the proceeds would be impressed with a trust in favor of the Northern Pacific, is the case of *Home Insurance Company of New York v. Baltimore Warehouse Co.*, 93 U. S. 527, 23 L. Ed. 868.

In this case the insurance company issued to the warehouse company a policy of fire insurance "on merchandise; their own, or held by them in trust, or in which they have an interest *or liability*". At the time of the loss, the property was in the possession of the warehouse company as bailee. The owners of the property also took out insurance upon the same property. The question was as to contribution between the policies. The court below charged the jury that these policies, if upon the same property, were liable to contribution. The insurance company con-

tended that only the interest of the warehouse company in the goods was insured. Concerning the meaning of the policy, the court said:

"In those cases, as in all others, the subject of the insurance, its nature and its extent, are to be ascertained from the words of the contract which the parties have made. It is true of policies of insurance as it is of other contracts that, except when the language is ambiguous, the intention of the parties is to be gathered from the policies alone. There are cases in which resort may be had to parol evidence to ascertain the subject insured; but they are cases of latent ambiguity. So, in the construction of other contracts, parol evidence is admissible to explain such ambiguities. In this particular, the rule for the construction of all written contracts is the same. Lord Mansfield said long ago that courts are always reluctant to go out of a policy for evidence respecting its meaning. Loraine v. Thomlinson, Doug., 585. And so are the authorities generally. Astor v. Ins. Co., 7 Cow. 202; Murray v. Hatch, 6 Mass. 465; Levy v. Merrill, 4 Me. 180; Ins. Co. v. Loney, 20 Md. 36; Arn. Ins., 1316, 1317, and n.; 2 Greenl. Ev. 377."

* * * *

"Turning, then, to the policy issued to the plaintiff below, and construing it by the language used, the intention of the parties is plainly exhibited. Its words are: The Home Insurance Company 'insure Baltimore Warehouse Company against loss or damage by fire, to the amount of $20,000, on merchandise hazardous or extra hazardous, their own or held by them in trust, or in which they have an interest or liability, contained in' a certain described warehouse. There is nothing ambiguous in the description of the subject insured. It is as broad as possible. The subject was merchandise stored or contained in a warehouse. It was not merely an interest in that merchandise. The

merchandise of the Warehouse Company, owned by them, was covered, if any they had. So was any merchandise in the warehouse in which they had an interest *or liability.* And so was any merchandise which they held in trust. The description of the subject must be entirely changed before it can be held to mean what the insurers now contend it means." (p. 869.)

* * * *

"It is, undoubtedly, the law that wharfingers, warehousemen, and commission merchants, having goods in their possession, may insure them in their own names, and in case of loss may recover the full amount of insurance, for the satisfaction of their claims first, *and hold the residue for the owners.* Waters v. Assur. Co., 5 Ell. & Bl. 870; R. Co. v. Glyn, 1 Ell. & Ell. (Q. B.) 652; DeForest v. Ins. Co., 1 Hall 136; Siter v. Morrs., 13 Pa. St. 219." (p. 869.) (Italics supplied).

The court points out that the warehouse receipts contained notices that the warehouse company held the property as bailees only, "and was not insured by the corporation." The court then concludes:

"Without pursuing this discussion further, we have said enough to vindicate our opinion that the policy upon which this suit was brought covered the merchandise held by the Warehouse Company on storage, and not merely the interest of the bailee in that property. It follows, necessarily, that there was double insurance. The policy issued to the Warehouse Company and those obtained by the depositors of the merchandise, covered the same property, and they were for the benefit of the same owners. The persons assured were the same; for if the policies taken out by Hough, Glendennin & Co. were upon their goods, notwithstanding the memorandum that the loss, if any, was payable to the Baltimore Warehouse Company,

as may be conceded was the case, so was the policy now in suit. The insurers are liable, therefore, *pro rata*, each contributing proportionately." (p. 870.)

To the same effect:

"It was lawful for the plaintiff to insure in its own name goods held in trust by it; and it can recover for the entire value, holding the excess over its own interest in them for the benefit of those who have entrusted the goods to it." (Citing cases.)

California Insurance Co. v. Union Compress Co., 133 U. S. 387, 10 S. Ct. 365.

"But a carrier has such an insurable interest in goods entrusted to it for carriage, that it may insure, not only its interest or its liability, but the whole value of the goods, and in such case it may collect the whole value, and, after reimbursing itself for its special loss, *it will hold the surplus in trust for the owner.* 1 Wood, Ins. Sec. 294; Home Ins. Co. v. Baltimore Warehouse Co., 93 U. S. 541. An insurance for the benefit of a carrier upon the goods in its custody, not limited to an insurance of its liability or interest, is an insurance of the whole value, and one in which the owner has an interest. The case of Home Insurance Co. v. Baltimore Warehouse Co. is an instructive and well-reasoned case, and meets our approval."

Lancaster Mills v. Merchants' Cotton-Press & S. Co., 14 S. W. 317 (Tenn.), per Judge Lurton.

See also, *Fire Insurance Assn. v. Merchants & Minors Transportation Company*, 7 Atl. 905, (Md.); *Brooklyn Clothing Corporation v. Fidelity Phoenix Fire Ins. Co.*, 200 N. Y. S. 208.

It will be noted that this principle of law is ancient. In the *Home Insurance Company* case, *supra*, the

ance, Sec. 1935, p. 6438, and a note to be found in 66 A. L. A. 864, all to the effect that a lessor may not recover on an insurance policy taken out by the lessee unless there be a covenant in the lease requiring the lessee to take out such insurance.

It will be noted that the foregoing cases and citations deal with the relationship of lessor and lessee. The same rule is similarly stated as to landlord and tenant (26 C. J. 436), vendor and purchaser (26 C. J. 437), and mortgagor and mortgagee (26 C. J. 438), although there is respectable authority *contra.*

Passing any question as to the general rule cited by plaintiff, there is a specific exception as well recognized as the rule itself. The exception applicable to bailments is stated at 26 C. J. 443-444. As already shown in the case of *Home Insurance Co. v. Baltimore Warehouse Co., supra,* the Supreme Court of the United States itself has recognized the exception to the general rule.

Robert Williams & Co. v. Auto Express Co.

A case squarely in point, recognizing the exception to which we have just referred, and which is not to be distinguished from the instant matter, is *Robert Williams & Co. v. Auto Express Co.*, 78 Atl. 670, (N. J. Equity).

Plaintiff delivered silk ribbons to defendant for transportation to New York. It was destroyed by fire while in possession of the carrier. The carrier "had previously procured insurance against loss or damage by fire on merchandise consisting principally of silk and silk goods in transit * * * and for which they are *liable* as common carriers." The carrier made an assignment to the shipper just before the carrier's insolvency. Both the shipper and the receiver for the carrier claimed the money.

Relying on the cases of

Home Ins. Co. v. Baltimore Warehouse Co., 93 U. S. 527, 23 L. Ed. 868;

California Ins. Co. v. Union Compress Co., 133 U. S. 387, 33 L. Ed. 730;

Waters v. Monarch Ins. Co., 5 El. & Bl. 870, 25 L. J. Q. B. 102;

Stillwell v. Staples, 19 N. Y. 401;

Waring v. Indemnity Fire Ins. Co., 45 N. Y. 606, 6 Am. Rep. 146;

Lancaster Mills v. Merchants' Cotton Press Co., 14 S. W. 317, 24 Am. St. Rep. 586, (Tenn.);

Fire Ins. Assn. v. Merchants' Co., 7 Atl. 905, 59 Am. Rep. 162, (Maryland);

Roberts v. Firemen's Ins. Co., 30 Atl. 450, 44 Am. St. Rep. 642 (Pennsylvania)

the court holds:

"The phraseology of the insurance policy in this case is not substantially different from that contained in

the policies adjudicated upon in the cases above cited. In each and all of the cases the policy was procured by a bailee, and was for the benefit of a bailor, and in every case was held to be direct insurance on the goods of the bailor, thus giving the bailor an interest in the policy from the time of its issuance. This interest is, however, subject to any interest which the bailee may have under the policies. It appears in this case that the bailee has no interest to protect, and that therefore whatever moneys are derived from the policies belong to the bailor.

"It was argued that the assignment made by the express company to the petitioner of an interest in this fund was invalid for the reason that the assignment was made of assets of the corporation in contemplation of insolvency, and that there was thus a violation of the terms of section 64 of our corporation act, P. L. 1896, p. 298. If the petitioner's right stood on the assignment there might be some reason for this contention, but it does not so stand. Whatever right the petitioner has arose out of the policies of insurance, and became efficient for the petitioner's protection as soon as the insurance was effected." (p. 672.)

This case, therefore, if viewed from the standpoint of a liability policy, must be resolved in favor of the Insurance Company by the application of the fundamental principle enunciated by the foregoing cases and citations, that:

The Insurance Company having paid the Railway Company, plaintiff cannot maintain this action because the proceeds of an insurance policy taken out by a bailee is impressed with a constructive trust in favor of the bailor (Railway Company) even if the

policy is taken out without the knowledge of the bailor.

This case is therefore to be resolved exactly as if the Northern Pacific, the owner of the cars, had been named beneficiary in the endorsement. In such a case, of course, plaintiff would not even contend that the Insurance Company did not properly apply the fund. This must be so because the endorsement insures against "legal liability". The legal liability is that of the insured to the Northern Pacific.

It follows, therefore, that whether the insurance policy be construed as an indemnity policy or a liability policy, the result is the same—plaintiff cannot successfully maintain its action.

We again desire to recur to the basic facts, which, in and of themselves, are decisive and controlling:

(1) The insurance policy is against *legal liability only.*

(2) There is no legal liability.

What is "legal liability"? In *Royal Insurance Co. v. St. Louis, San Francisco Ry. Co.*, 291 Fed. 358, the policy insured a railroad against legal liability for cotton carried by it and destroyed by fire. The court held legal liability was established by a judgment in the State Court holding the carrier liable in an action

by the shipper, of which action the insurer could assume the defense. As to the definition of what constitutes legal liability, the court said:

"As we understand it, the term 'legal liability' in such contracts as is involved in this action, is a liability which our courts of justice, in this country, recognize and enforce as between parties litigant therein."

To the same effect see 5 Couch on Insurance, Sec. 1210.

Under the facts shown by the stipulation, is there a liability which the Northern Pacific can *enforce* against the plaintiff? There are many answers,—one is sufficient. The Northern Pacific has released the plaintiff.

Liability must be such as to be *enforceable* in a court of justice. Can the Northern Pacific enforce liability against the plaintiff in the face of a release *and* full recoupment for its loss?

The purpose of the policy in question was to protect the insured from having to pay the Northern Pacific for loss of its cars. The insured was not seeking to protect itself against loss of its own property because it did not own the cars. If the insured be protected from having to pay the owner of the cars for their loss, the policy has served every purpose for which it was procured. This is exactly what has hap-

pened, for payment by the defendant to the Northern Pacific has extinguished the liability of the insured to the railway company and it has received full release from the railway company. Therefore, as the policy has fully accomplished the purpose for which it was taken out, the insured has received full value for the premium paid.

Plaintiff brings this action not to protect the Northern Pacific, but with the hope that the proceeds of the insurance belong to the receiver for distribution to preferred and general creditors, divested of any trust character.

Had insured remained solvent, certainly it would not have brought the case at bar for it could not possibly make a profit therefrom. The fortuitous circumstance that insured went into the hands of a receiver certainly did not increase the rights it otherwise had. The only change in the situation arising out of the insolvency of insured is the desire, doubtless commendable, of the receiver to secure money to divide among other creditors. But creditors have sustained no loss of which they can complain. They had no interest in the cars. Only the Northern Pacific sustained a loss and only it should receive reimbursement from the fund created by insured for the very purpose of indemnifying that loss.

In good conscience, we ask: *Who suffered this loss?* The plaintiff has suffered no loss by destruction of these 22 cars, only 12 of which are covered by the policy.

The Northern Pacific is the only one sustaining a loss by reason of their destruction. The plaintiff cannot recover until it has suffered a loss. It never will suffer a loss because the claim of the Northern Pacific is released and extinguished. Nor is there an existing and enforceable legal liability.

Finally,—suppose the Northern Pacific were now suing the plaintiff for the non-return of the flat cars. Would it not be a good defense for the plaintiff to show its release and discharge? *The Insurance Company is entitled to raise any defense in this action that the plaintiff could raise against the Northern Pacific.* Without a right in the Northern Pacific to enforce a claim against the plaintiff, the plaintiff has no right against the Insurance Company. Water cannot rise higher than its source.

The defendant is entitled to an affirmance of the judgment insofar as it denies recovery on account of the N. P. logging flat cars.

SUMMARY

Summarizing our position:

If the policy be viewed as an indemnity policy, then—

(a) Plaintiff has not yet suffered actual loss, and until it does suffer actual loss it has no cause of action. (*Ford v. Aetna Life Ins. Co.*, 70 Wash. 29, 126 Pac. 69);

(b) An indemnitor has the right to extinguish the claim indemnified against. (*Sanders v. Frankfort Marine, etc., Ins. Co.*, 57 Atl. 655, N. H.)

If the policy be viewed as a liability policy, then—

(a) Legal liability has been extinguished by the waiver and releases executed by the Northern Pacific to the plaintiff and to the Insurance Company.

(b) The Northern Pacific could not enforce a liability against the plaintiff for which it has been fully compensated;

(c) If the Northern Pacific is entitled to judgment against the plaintiff, then the Northern Pacific would be entitled to immediately proceed directly against the Insurance Company by garnishment or otherwise. (*Fenton v. Poston*, 114 Wash. 217, 192 Pac. 31.) This being so, and the stipulation showing that the Insurance Company has aleady paid the Northern

Pacific, there can be no basis of complaint on the part of the plaintiff. In other words, to recover plaintiff must prove that the Northern Pacific has a cause of action against it. When plaintiff has proved this, then it follows as a matter of law that the Northern Pacific is entitled in turn to judgment direct against the Insurance Company by garnishment or otherwise;

(d) An insurer under a liability policy may also settle direct with the party damaged (*Anoka Lumber Co. v. Fidelity & Casualty Co.*, 65 N. W. 353, Minn.) This is all that has taken place in the case at bar.

In addition to the foregoing reason, we say that whether the policy be an indemnity or liability policy:

(a) A bailee who takes out insurance in its own name without the knowledge of the bailor, is trustee for any excess above its claim after a loss. Here, if the plaintiff receives from the Insurance Company money representing the Northern Pacific flat car loss, such money is a trust fund entirely belonging to the Northern Pacific. In other words, under the law the Northern Pacific is immediately entitled to any money which would be paid to the plaintiff by the Insurance Company. The stipulation shows that the Northern Pacific has received that money for the loss direct

from the Insurance Company and has executed its releases. Under such circumstances, from the very nature of the rights of the parties, there is no cause of action. A case in point: *Robert Williams & Co. v. Auto Express Co.*, 78 Atl. 670 (N. J.).

We respectfully submit that the judgment entered by the lower court denying recovery to plaintiff on account of the Northern Pacific logging flat cars should be affirmed.

Respectfully submitted,

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APPENDIX

(For complete Memorandum Decision see Tr. 58-63; also as reported 8 F. Supp. 394.)

"In the District Court of the United States, for the Northern District of Washington, Northern Division.

No. 20512

GUY H. CLARK, as Receiver of the Montborne Lumber Company, a corporation, Plaintiff,

vs.

NORTH RIVER INSURANCE COMPANY, a corporation, Defendant.

MEMORANDUM DECISION

" * * * As to the logging flat cars owned by the Railway Company, it seems to me that in the final analysis the question of defendant's liability under the policy must turn upon the effect to be given to the endorsement on the policy that 'It also understood and agreed that this policy covers the legal liability only of the assured on logging cars owned by others * * *'. In the law relating to insurance as well as other contracts, the rule is that specific provisions must control over general provisions, and construing the policy, together with said endorsement, it is obvious that the parties intended that liability of the assured rather than loss or damage to the insured, was the thing insured against. By reason of the settlement

of the question of damage to the cars made direct by the defendant with the Railway Company, and the release and discharge of the Lumber Company and the plaintiff receiver by the Railway Company, controlling evidence of which may be found by a reference to 'Exhibit 3' attached to the stipulation of facts filed herein May 1, 1934, plaintiff has wholly failed to prove, what was required of him, that, as a result of the damage to the cars, assured is legally liable to the Railway Company in any sum. Plaintiff, therefore, has not sustained the burden of proof as to his claim or claims set forth in the complaint herein as to the cars, no matter on what theory, nor under what kind or nature of an insurance policy, such claim or claims may have been asserted. In fact, all of the proof on this question conclusively shows that the Lumber Company and plaintiff have no legal liability whatsoever to the Railway Company or the owner of the cars. It, therefore, is unimportant whether the policy was an indemnity, a liability, or a so-called 'fire policy,' because, as to the cars, plaintiff has proved no facts warranting recovery under any theory or under any kind of policy. On this issue as to the cars, the judgment of the court will be for the defendant. * * * "

JOHN C. BOWEN,

United States District Judge."